Supreme Court, U.S.
FILED
MAR 3 2003
CLERK

(5)

No. 02-299

IN THE

Supreme Court of the United States

ENTERGY LOUISIANA, INC.,

Petitioner,

v.

LOUISIANA PUBLIC SERVICE COMMISSION, ET AL.,

Respondents.

Petition for a Writ of Certiorari to the Supreme Court of Louisiana

BRIEF OF *AMICUS CURIAE* EDISON ELECTRIC INSTITUTE IN SUPPORT OF PETITIONER

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WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

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INTEREST OF THE *AMICUS CURIAE*[1]

Edison Electric Institute ("EEI") is the national association of U.S. shareholder-owned electric utilities, their affiliates and industry associates worldwide. Its members are located in forty-nine states and the District of Columbia. They generate approximately three quarters of all electricity generated by electric companies and serve about seventy percent of all retail customers in the nation. They own about 70% of transmission system facilities in the country. EEI members are extensively regulated at both the federal and state levels.

EEI's concerns with the Louisiana Supreme Court's decision are rooted in the changes currently underway in the electric industry. In order to promote competitive multi-state markets for electricity, the Federal Energy Regulatory Commission ("FERC") is moving the industry toward regional management of the interstate transmission grid by new entities – Regional Transmission Organizations ("RTOs") – that will be regulated by the federal government. These entities are assuming significant control over both the transmission of electricity in interstate commerce and the supply of energy to satisfy consumer demand. The agreements to form and operate these RTOs will be subject to FERC rate regulation and, like the agreement among

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[1] Both parties have consented to the filing of this brief in letters lodged with the clerk. This brief was not authored in whole or in part by counsel for a party to this proceeding, and no person or entity other than the *amicus curiae* or its members made a monetary contribution for preparation of this brief. Counsel for *amicus*, Steptoe & Johnson LLP, served as counsel for petitioner Entergy Louisiana in the earlier proceedings before FERC. However, Steptoe & Johnson did not represent Entergy Louisiana in any of the proceedings below.

operating utilities in the Entergy system, will require EEI members in different states to bear significant costs. If individual state utility commissions could prevent utilities from recovering some or all of the costs assigned to them under these FERC-jurisdictional agreements, EEI members could face enormous financial hardship and FERC's efforts to promote regional electricity competition could collapse. EEI therefore seeks reversal of the decision below.

STATEMENT

A. Traditional Structure of the Electric Industry

FERC is promoting a structure for the electric industry that is radically different from the industry that existed in the past. Until fairly recently, the industry was dominated by vertically-integrated utilities that provided all three elements of the business – generation, transmission, and distribution – to customers in a defined service area. As regulated monopolies, utilities were subject to "cost of service" regulation by state public utility commissions. Each electric utility planned investments for generation and transmission in its franchised service area as a separate local unit. *New York v. FERC*, 122 S. Ct. 1012, 1016-17 (2002).

While continuing to operate as separate vertically-integrated companies, utilities began to coordinate their operations through the interconnection of their electric systems, which enabled them to share generation reserves for reliability and buy and sell electricity in order to lower operating costs.[2] In 1935, Congress enacted the Federal Power Act to regulate this growing wholesale electric

[2] *Gainesville Utils. Dep't v. Florida Power Corp.*, 402 U.S. 515, 520-24 (1971); *Pub. Util. Holding Co. Act of 1935: Hearings on S. 1725 Before the Senate Comm. on Interstate Commerce*, 74th Cong. at 798 n.1 (1935).

market, in part because the Commerce Clause prohibited the states from regulating it. *New York v. FERC*, 122 S. Ct. at 1017. The Federal Power Commission (FERC's predecessor) was given exclusive authority over wholesale bulk power sales by public utilities, while the states continued to regulate utilities' retail sales. Congress also granted the Commission exclusive jurisdiction over interstate transmission. *Id.* The wholesale/retail "bright line" served to distinguish FERC-jurisdictional service from service regulated by the states without the need for case-by-case adjudication of Commerce Clause issues. *FPC v. Southern California Edison Co.*, 376 U.S. 205, 211, 215-16 (1964).

This jurisdictional line, however, is not as bright as might appear on first impression since, by their nature, wholesale costs must become embedded in the retail rates of electric utilities. As wholesale trading expanded rapidly in the 1970s, disputes over the scope of federal versus state regulation arose. A considerable body of case law developed at the state court level, holding that states were prohibited from re-evaluating the FERC-regulated wholesale rates and disallowing those deemed unreasonable for retail ratemaking purposes. *See, e.g., Narragansett Electric Co. v. Burke*, 381 A.2d 1358 (R.I. 1977), *cert. denied*, 435 U.S. 972 (1978). This Court ultimately agreed: "a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . . Such a 'trapping' of costs is prohibited." *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 970 (1986); *see also Mississippi Power & Light Co. v. Miss. ex rel. Moore*, 487 U.S. 354 (1988).

B. The Transition To Regional Wholesale Electric Competition

Beginning in 1995, FERC initiated a series of rulemakings designed to promote competition for the supply of electricity at wholesale by opening up the interstate

transmission grid to competing power suppliers. FERC envisioned the development of regional power markets in which power suppliers could use the transmission grid to compete on an equal basis to supply power at the wholesale level. The Commission pointed to two developments in the industry that set the stage for these rulemakings.

First, the process of system integration among utilities had accelerated, due in part to technological advances that made it possible to transmit electricity efficiently at high voltages over long distances. By 1967, "[i]nterconnections, direct and indirect, among utilities [were] a far more vital part of the industry's operations."[3] Today, virtually every utility has access to the highly interconnected transmission system. *New York v. FERC*, 122 S. Ct. at 1017-18. As FERC noted, "Physically isolated systems have become a thing of the past."[4]

Second, FERC found that a new class of wholesale suppliers – the "independent power producers" – was entering the market to compete with traditional utilities, and that these independents required non-discriminatory access to the transmission grid to be able to compete. Order No. 888, 61 Fed. Reg. at 21,545-46. In fact, a number of states encouraged utilities to rely on competitive procurement

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[3] *Federal Power Act Amendments of 1967, Hearings on H.R. 5348, H.R. 5637, H.R. 7799, H.R. 8426, H.R. 8919, H.R. 9174 Before the Subcomm. on Communications and Power of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., at 118 (1967) (statement of Lee C. White, Chairman, FPC).

[4] Order No. 888, 61 Fed. Reg. 21,540, 21,545 (1995), *aff'd in part sub nom. Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff'd jurisdictional ruling sub nom. New York v. FERC*, 122 S. Ct. 1012 (2002).

arrangements to obtain low cost power rather than building their own power plants subject to cost-based regulation.

C. The New Industry Structure

1. Order No. 888

Based on these findings, the Commission set out to remove restrictions on access to the interstate transmission grid. Under Order No. 888, FERC implemented an "open access" policy: transmission owners must provide access to their transmission networks for other users on the same rates, terms, and conditions enjoyed by the utilities themselves. Order No. 888, 61 Fed. Reg. at 21,541; *see also New York v. FERC*, 122 S. Ct. at 1019-20. All transmission owners were required to file with FERC prescribed open access transmission tariffs to achieve this result. Order No. 888, 61 Fed. Reg. at 21,541, 21,597.

However, FERC also recognized in Order No. 888 that providing access to the grid on a utility-by-utility basis might not be sufficient to permit competition to develop efficiently over broader regions because of the high cost to acquire transmission service passing through multiple systems, each charging its own rate. FERC was also concerned with what it perceived as the balkanized structure of the transmission grid. *Id.* at 21,1551, 21,595-97. Order No. 888 therefore encouraged the creation of independent system operators ("ISOs") – FERC-regulated public utilities that would have a management independent of participants in the wholesale markets. *Id.* at 21,596. An ISO would be responsible for coordinating the operation of the transmission assets owned by a number of neighboring utilities and would administer a single open access transmission tariff for these utilities. FERC approved several agreements among utilities to form ISOs following Order No. 888, including entities in the Mid-Atlantic region, New England, New York and

California. *See Atlantic City v. FERC*, 295 F.3d 1 (D.C. Cir. 2002).[5]

2. Order No. 2000

In the wake of Order No. 888, a substantial number of new participants entered the marketplace, resulting in significant growth in the volume of wholesale trading. These changes, according to FERC, "placed new stresses on regional transmission systems," as an increasing number of parties were using the grid in ways that differed markedly from the uses that prevailed before Order No. 888.[6] Whereas power flows were fairly predictable before the advent of open access, power now moved along transmission lines in unprecedented volumes and in unexpected directions under conditions for which those facilities were not designed. The interstate transmission system, the Commission observed, had thereby become vulnerable to both reliability and efficiency problems. Order No. 2000, 65 Fed. Reg. at 814.

In light of these concerns, FERC promulgated Order No. 2000. Its purpose was to advance the formation of RTOs, which have many of the same characteristics as the ISOs introduced in Order No. 888. "Our objective is for all

[5] With the exception of California, the regions that set up ISOs pursuant to Order No. 888 had already been operating as regional "power pools" in which power from generating plants was centrally dispatched by a single operator and access to the transmission grid was on a pool-wide basis. *See Atlantic City*, 295 F.3d at 4. In California, an ISO was established when the State decided to restructure its electric utilities and permit retail electric consumers to purchase electricity in a competitive market.

[6] Order No. 2000, 65 Fed. Reg. 810, 813 (2000), *pet. for review dismissed sub nom. Pub. Util. Dist. No. 1 of Snohomish County v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

transmission-owning entities in the Nation, including non-public utility entities, to place their transmission facilities under the control of appropriate RTOs in a timely manner." Order No. 2000, 65 Fed. Reg. at 811. In FERC's opinion, this structural change was necessary because the market was insufficiently competitive due to engineering and economic inefficiencies and because of continued opportunities for discrimination under Order No. 888. *Id.* at 823-25. It was also thought that RTOs would benefit the public through the introduction of regional planning and operation of the electric grid. *Id.* at 811.

Under FERC's scheme, the transmission owners in a multi-state region would transfer functional control over their facilities to the RTO through various contractual arrangements filed with FERC. FERC did not mandate a particular type of RTO structure, giving prospective RTO participants the "flexibility to develop mutually agreeable regional arrangements." *Id.* at 834. However, FERC established minimum requirements for RTOs, including minimum scope and configuration requirements so that wholesale power trading would take place in sufficiently large market areas. *Id.* at 843, 859.

Consistent with Order No. 2000, EEI member utilities are currently investing billions of dollars to make RTOs a reality. A FERC study indicates that RTO start-up costs will range from $1 billion to $5.75 billion.[7] According to other studies, the ongoing operation costs for RTOs will range from $75

[7] ICF Consulting, *Economic Assessment of RTO Policy* at vii, prepared for FERC (Feb. 27, 2002), *available at* www.ksg.harvard.edu/hepg/papers/ferc%201cf%20rtostudy_final_0226.pdf.

million to $100 million annually per RTO.[8] The annual operating budgets of some existing RTOs already exceed that amount by a significant margin. For example, the 2003 annual budget of the PJM RTO exceeds $150 million.[9] The costs to start up and operate RTOs are charged to utilities under FERC tariffs, and in order to make the utilities whole these costs must be passed through to retail customers pursuant to state-regulated retail service rates.

The formation of an RTO requires an agreement among the utility transmission owners to coordinate or "pool" their transmission operations under an RTO's effective control. These agreements are similar to the Entergy System Agreement at issue before the Court in that they are tariffs that must be filed with FERC pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d (2000). They are also similar in that they assign responsibility for decisions relating to the sharing of wholesale power and transmission costs to a management entity operating at the regional level, subject to FERC jurisdiction. Utilities participating in the RTOs must then recover these costs from retail customers pursuant to rates regulated by the states.

For example, the RTO formation agreements assign to the regional entities, at FERC's direction, responsibility for administering regional transmission tariffs. Under the tariffs, utilities furnishing transmission assets recover their capital

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[8] *See, e.g.*, Tabors Caramanis & Associates, *RTO West/Benefit Cost Study, Final Report Presented to RTO West Filing Utilities* at ix (Mar. 11, 2002), *available at* www.ksg.harvard.edu/hepg/papers/tabors%20ca%20bencost_031102_rtowestbcfinalrevised/pdf.

[9] *See* Approved 2003 Budget and Service Category Rates, *available at* www.pjm.com (Finance Committee).

and operating costs through FERC-regulated rates. In all states where retail services have been unbundled, utilities using the grid will be required to purchase transmission service from the RTOs under the regional tariffs at FERC-regulated rates. The utilities will then have to recover the costs of that service from retail customers via state-regulated rates.

In addition, FERC has assigned to RTOs primary responsibility for planning upgrades to the interstate transmission grid. When new facilities are constructed, the RTO will file rates at FERC to recover the costs of the upgrades from transmission users, including utilities in their roles as providers of retail service. The costs of transmission expansions assigned to utilities by the RTO, and approved by FERC, must then be charged through to retail customers via state-regulated rates for retail service.

The multi-state contracts also assign to RTOs responsibility for establishing and administering wholesale markets for power. This will require the RTOs to purchase complex computer systems – both hardware and software. In addition, the utilities will participate in the markets administered by the RTOs as buyers and sellers in order to satisfy their retail service obligations. All costs incurred by utilities in these markets to serve their retail customers will be pursuant to FERC-approved tariffs, and these costs will have to be charged through to retail customers under state-regulated rates for retail service.

3. Standard Market Design

Most recently, FERC has proposed a standard market design ("SMD") rulemaking, which it calls the "final book of

the trilogy."[10] According to FERC, the proposed rule is needed to eliminate residual balkanization on the transmission grid by standardizing the rules across regions for designing wholesale power markets and operating the transmission grid. 67 Fed. Reg. at 55,455. Under this proposed rule, all public utilities would be required to transfer operating authority over their transmission assets to an independent transmission provider, and this independent entity would be required to put in place uniform rules for both transmission service and wholesale market design. *Id.* These rules would create spot markets for power that utilities with obligations to serve retail customers would use to meet the demand for power on a day-ahead and real-time basis.

As proposed, the SMD would extend to all interstate transmission service, including transmission service that is provided as part of a bundled sale of electricity to retail customers, which previously had been regulated by the states. *Id.* at 55,468, 55,470. Therefore, the SMD would place under FERC regulation all of the charges to retail customers for the use of a utility's interstate transmission assets; billions of dollars of revenues annually would be affected. Utilities would then be required to include these charges in state-regulated tariffs for retail service.

SUMMARY OF ARGUMENT

FERC has exclusive jurisdiction to determine compliance with tariffs filed under the Federal Power Act. The LPSC conceded this point in its own decision. Here, however, it argues that it can scrutinize the prudence of a utility's costs when it determines that the utility's conduct is inconsistent

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[10] *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design; Proposed Rule*, 67 Fed. Reg. 55,452, 55,454-55 (2002).

with the terms of a FERC-filed tariff. This ignores the basic rule that a state's "prudence review" is preempted when it traps costs incurred pursuant to a tariff on file with FERC. *MP&L*, 487 U.S. at 374; *Nantahala*, 476 U.S. at 970.

In the context of multi-state organizations, a state's prudence review will inevitably trap costs. The utilities do not act autonomously of the other utilities in the multi-state system, and do not have the authority to disregard decisions of the regional entity. If a state commission prohibits an individual utility from recovering costs mandated by the regional entity, the utility must either absorb those costs or shift them to the ratepayers of utilities located in other states. Both outcomes are preempted because they frustrate the federal scheme.

Moreover, the LPSC's position poses a serious risk of conflicting state interpretations. Decisions must be made by the management of regional entities under system agreements that do not specify simple numbers, but use formulas or other factors. Due to their complexity, these agreements are often subject to different interpretations. Decisions by one state's regulators concerning the allocation of costs or revenues pursuant to such tariffs may conflict with the decisions of other states on the same issues. Those conflicts will inevitably cause the trapping of costs. In view of the need for a uniform interpretation of the filed tariff, FERC is the proper forum to decide these multi-state battles.

This Court should therefore draw a bright line establishing that FERC has exclusive jurisdiction to interpret and enforce tariffs governing multi-state entities. A bright line approach is particularly important because of the increasingly central role of regional entities in the industry. Under FERC-regulated, multi-state agreements, RTOs will make allocation decisions involving billions of dollars for start-up costs, operating expenses and investments in the transmission grid. This new structure cannot work if those

decisions can be second-guessed by state regulators with conflicting views on the meaning of the regional agreement.

Moreover, the exception to the filed-rate doctrine created in *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983) would not authorize a state to scrutinize costs incurred by utilities in multi-state organizations. The premise of *Pike County* is that the utility had a choice to purchase power at a lower price. In the multi-state context, however, this element of choice is missing. The participant in an RTO or multi-state holding company has no choice but to follow the decision of the regional entity. The prudence inquiry is therefore impermissible because the state commission would in effect be regulating the decision of the regional entity, which is subject to FERC's exclusive jurisdiction.

The LPSC concedes that FERC's interpretation of the tariff, when given, is authoritative. The LPSC claims that it can decide whether a utility has violated a FERC tariff prior to any FERC decision on that issue. This conflicts with the approach consistently followed by this Court that, if FERC has jurisdiction, that jurisdiction is exclusive. Moreover, the LPSC's approach is impractical. The parties would have to engage in extensive litigation at the state level, subject to having the entire state decision reconsidered by the FERC. And if FERC disagrees with the state's original position, the utility would need to seek retroactive relief to become whole. Where the states have concerns about the administration of a multi-state agreement, they can pursue their remedy at FERC.

For these reasons, the decision of the Louisiana Supreme Court should be reversed. This Court should hold that only FERC can interpret and enforce the terms of the filed multi-state system agreement.

ARGUMENT

I. STATE PRUDENCE REVIEW OF ACTIONS TAKEN PURSUANT TO MULTI-STATE AGREEMENTS FILED WITH FERC WOULD FRUSTRATE THE PURPOSES OF THE FEDERAL POWER ACT

A. Under This Court's Decisions, State Prudence Review Conflicts With FERC's Exclusive Jurisdiction

FERC's jurisdiction over filed tariffs is exclusive. *Nantahala*, 476 U.S. at 966, 969; *New England Power Co. v. New Hampshire*, 455 U.S. 331, 340 (1982). Indeed, in the proceedings below, the LPSC conceded that "FERC had exclusive jurisdiction over the issue of whether the System Agreement has been violated." Pet. App. 65a. It stated:

> [T]his Commission is pre-empted from determining whether the terms of a FERC tariff have been met, for the issue of violation of or compliance with a FERC tariff is peculiarly within FERC's purview. Any allegation of a violation of a FERC-tariff should therefore be brought before the FERC.

Pet. App. 64a; *see also* Pet. App. 72a.

The LPSC nevertheless argued that Congress did not preempt the jurisdiction of Louisiana to conduct a prudence review of decisions made pursuant to the terms of a federally regulated multi-state system agreement. In the LPSC's view, it had authority to inquire into the prudence of those decisions in order to determine the *retail* costs of service. (Pet. App. 69a-72a). Thus, the LPSC asserts the right to determine whether the actions taken were inconsistent with the terms of the federal tariff.

The LPSC is mistaken. The Federal Power Act preempts inconsistent state law regardless of the source of authority. State courts are preempted from affecting FERC-filed rates by awarding damages under state contract law, *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981); state legislatures are preempted from affecting wholesale rates under their taxing powers, *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983); and a state utility commission cannot prevent regulated utilities from passing through to retail customers costs incurred under FERC-mandated wholesale rates:

> When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . . Such a 'trapping' of costs is prohibited.

Nantahala, 476 U.S. at 970.

The LPSC's prudence review would create precisely the sort of impermissible conflict with FERC jurisdiction that the Court prohibited in *Nantahala* and *MP&L*. In *Nantahala*, the Court reversed a decision of the state supreme court allocating costs to a utility differently from the amount allocated by FERC in a wholesale ratemaking proceeding. The Court found that costs incurred by a utility would be "trapped" unlawfully if they could not be passed on to ratepayers. *Id.* Thus, the state commission's allocation of costs was preempted as an "impermissible interference . . . with the scheme of federal regulation." *Id.*

In *MP&L*, the Court observed that "the only purpose of the prudence review ordered by the [state] was to determine whether the costs FERC had directed MP&L to pay for its allocation of Grand Gulf power should be 'trapped' or passed

onto MP&L's retail customers." 487 U.S. at 372 n.12. The Mississippi state court sought to distinguish *Nantahala* on the ground that FERC's rate order never expressly addressed the prudence of the utility's decisions. This Court rejected the notion that federal preemption turned on whether "a particular matter was actually determined in the FERC proceedings." *Id.* at 374. "We have long rejected this sort of 'case-by-case analysis of the impact of state regulation upon the national interest' in power regulation cases." *Id.*

In short, *Nantahala* and *MP&L* hold that FERC's exclusive jurisdiction is necessary to assure that legitimate wholesale costs are not trapped. A state is indirectly dictating the wholesale price when it declines to give effect to the rate adopted by the federal Commission. That dictation frustrates the federal regulatory framework established by Congress. *See Arkansas Elec. Coop. Corp. v. Ark. Public Serv. Comm'n*, 461 U.S. 375, 389 (1983) ("a particular rate set by the [state utility commission] may so seriously compromise important federal interests . . . as to be implicitly pre-empted"); *City of New York v. FCC*, 486 U.S. 57, 64 (1988) (state action that "frustrates the purposes" of federal law is preempted); *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

B. The LPSC's Prudence Review Is Impermissible Because It Results In Trapped Costs

Here, the LPSC failed to see that its order would interfere with operations under a federally filed multi-state agreement in the same way. That agreement contemplated that the Entergy Operating System would make critical decisions as a unit. An amendment to the tariff in 1997 provided a procedure for determining charges for reserved capacity, specifying standards to be applied by the Operating Committee. (Pet. App. 157a-158a). FERC approved that arrangement in a proceeding that included the LPSC's

participation.[11] Once the Operating Committee had decided whether the disputed ERS units were to be included in that calculation, Louisiana Entergy had no choice but to include costs associated with those units, since the filed tariff then in effect required that it adhere to the decision of the Operating Committee. Thus, the LPSC's refusal to allow recovery of those costs was inconsistent with the mandate of a federally filed tariff and hence preempted under the holdings of *MP&L* and *Nantahala*.

Moreover, the LPSC's decision will result in exactly the same trapping of costs forbidden by those decisions. The Operating Committee decision required Entergy Louisiana to pay a portion of the costs associated with the ERS units. The LPSC, however, held that, because Louisiana Entergy had acted imprudently, it could not pass those costs through to its retail customers. (Pet. App. 75a). In this respect, Louisiana Entergy suffers from "trapped" costs contrary to this Court's clear holdings.

Even from a broader system perspective, the same result is likely. The LPSC's decision, while reducing rates for Louisiana consumers, had the concomitant result of either forcing the Entergy system to absorb the costs entirely, or forcing those costs onto customers located in other states (Arkansas, Texas, and Mississippi). Neither outcome is permissible. The first is manifestly a trapping of costs at the system level. The second will lead to the same result. The likely response of the neighboring states to LPSC's parochial interpretation is to adopt one of their own.[12] Thus, the multi-

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[11] *See Entergy Servs.*, 80 FERC (CCH) ¶ 61,197 (1997), *aff'd, Louisiana Pub. Serv. Comm'n v. FERC*, 174 F.3d 218 (D.C. Cir. 1999).

[12] FERC has already noticed this phenomenon in an analogous context: "If State Commission A orders a change to be

(Continued ...)

state system will be caught in a squeeze between states in which it cannot fully recover its costs. Inconsistency among state regulators, just as much as inconsistency between federal and state regulators, will lead to impermissible trapping of costs.

This case illustrates the harms that may arise from the attempts of state regulators to interpret tariffs filed by multi-state entities. At issue in this case is the allocation of costs associated with reserve capacity. Reserve capacity is a resource used to meet the demand for energy when the system-wide demand is at its peak.[13] By definition, reserve capacity may not be of immediate value to each individual entity within the system. But all members of the system benefit from the greater reliability of a system that has adequate reserve capacity to meet peak demand.[14]

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made in a wholesale rate filing, presumably because it would benefit the ratepayers in State A, then State Commission B might well retaliate by ordering a counter rate filing that would benefit the ratepayers in State B." *Western Massachusetts Electric Co.*, 23 FERC (CCH) ¶ 61,025 at 61,064 (1983). *See also Middle South Energy v. APSC*, 772 F.2d 404, 416-17 (8th Cir. 1985); *Commonwealth of Massachusetts v. United States*, 729 F.2d 886, 888 (1st Cir. 1984) (Breyer, J.).

[13] *See Gainesville Utils. Dep't v. Florida Power Corp.*, 402 U.S. at 520-24; *Louisiana Public Service Comm'n v. FERC*, 174 F.3d at 221-22; *see also* Stephen G. Breyer & Paul W. Macavoy, ENERGY REGULATION BY THE FEDERAL POWER COMMISSION, at 105-07 (1974).

[14] *See Louisiana Public Service Comm'n v. FERC*, 174 F.3d at 221-22; *see also Central Maine Power Co. v. FERC*, 252 F.3d 34, 38 (1st Cir. 2001).

Because of these characteristics, the temptation is great for a state regulator to question provisions for reserve capacity under a multi-state system agreement. By focusing on the short-term interests of its own constituents, a state regulator could make a determination with regard to costs for reserve capacity that conflicts with the interests of the system as a whole. The system agreement on file with FERC, however, protects against that contingency by providing a unitary method for making this determination for the entire system. The Federal Power Act also provides all parties with the ability to seek a remedy at FERC for any action inconsistent with the filed tariff. Individual state action determining that a multi-state entity has incorrectly decided a question of reserve capacity under the system agreement will frustrate the purposes of the Act.

Only FERC can fairly resolve the question of how the benefits and burdens should be shared among companies doing business in different states. It can both avoid trapped costs and protect overall system reliability. In usurping FERC's authority, the LPSC is interfering with the interests of other states, which are protected under the federal scheme. This Court has noted, the "production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests." *Arkansas Electric Coop.*, 461 U.S. at 377. By refusing to give effect to allocation decisions made by a multi-state holding company pursuant to a filed tariff, and subject to FERC review, the LPSC has acted in derogation of the federal scheme, as established by *MP&L* and *Nantahala*.

II. THE COURT SHOULD DRAW A BRIGHT LINE WITH RESPECT TO TARIFFS GOVERNING MULTI-STATE ENTITIES

This Court should draw a clear line establishing exclusive federal jurisdiction over the interpretation of multi-state system agreements. The Court has found that Congress intended that approach with respect to other aspects of FERC jurisdiction under the FPA. *See FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964) ("Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary . . . case-by-case analysis."); *see also Nantahala*, 476 U.S. at 966. A bright line approach to tariffs governing multi-state entities is particularly important because of the increasingly central role of regional entities in the industry.

A. FERC's Regionalization Plan Will Fail If States Can Review FERC Tariffs And Deny Cost Recovery

As explained above, FERC is now aggressively moving utilities into RTOs – independently managed regional entities consisting of unaffiliated transmission-owning utilities bound together by a contract filed with FERC. In addition, FERC is proposing that, within a fixed period of time, all RTOs implement a standard market design for wholesale power and transmission services. Starting with Order No. 888, the industry has already invested more than $100 billion in regionalization.[15]

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[15] Energy Security Analysis, Inc., *Impact of the Creation of a Single MISO-PJM-SPP Power Market,* at 8 (July 2002), *available at* www.miso-pjm-spp.com/information/general_documents/study_final_july 29.pdf.

The RTO agreements are enormously complex and could be vulnerable to different interpretations by states. Their provisions for allocating benefits and burdens among utility members are not like the traditional tariff, which fixes a price in an absolute number. Rather, the agreements assign responsibility for certain decisions to the RTO's independent management. As in this case (see Pet. App. 157-58a), an RTO decision may be guided by criteria set forth in the agreement filed at FERC that allow for discretion in its execution. In fact, FERC requires an RTO to be independent of all market participants so that it can exercise such discretion without undue influence from any party or industry sector. *See* 18 C.F.R. § 35.34(j)(1)(iii). Accordingly, state regulators may reach differing conclusions as to the intended meaning of an agreement, and whether the RTO has complied with it.

Disagreements of this kind among states could have serious financial implications for the industry. Under system agreements filed with FERC, utilities are incurring hundreds of millions of dollars in expenses to establish RTOs and putting billions of dollars in assets under their supervision. Implementation of FERC's proposed standard market design ("SMD") will require additional expenses to establish and operate uniform wholesale markets. One utility has estimated that implementation of SMD in the southeast region would cost an additional $55 to $60 million.[16] Annual RTO operating costs have been projected to range from $75

[16] Charles River Associates, *The Benefits and Costs of Regional Transmission Organizations and Standard Market Design in the Southeast*, at 22 (Nov. 6, 2002), *available at* www.crai.com/pubs/pub_2901.pdf.

million to $100 million annually per RTO[17] and are already significantly higher for at least one existing RTO. *See* note 9, *supra*. These costs will likely increase under the SMD rulemaking because the RTO would have additional market design and oversight responsibilities.

Under the LPSC's theory, however, any of these expenditures might be disallowed by an individual state as imprudent, even though undertaken pursuant to the decision of the independent RTO management under the RTO's system agreement. Some states have already objected to SMD on the ground that it will raise retail costs and have requested that SMD not be implemented at this time.[18] Thus, expenditures for RTO operations and SMD implementation could easily become trapped costs, even though mandated under FERC tariffs.

Similarly, a core purpose of FERC's RTO concept and the SMD is to encourage capital investment in upgrades to the transmission grid. Investment in transmission assets has lagged during the past decade, while demand for electricity

[17] *See, e.g.*, Tabors Caramanis & Associates, *RTO West/Benefit Cost Study, Final Report Presented to RTO West Filing Utilities* at ix (Mar. 11, 2002), *available at* www.ksg.harvard.edu/hepg/papers/tabors%20ca%20bencost_031102_rtowestbcfinalrevised/pdf.

[18] *See, e.g.*, Letter of Connecticut Att. Gen. to FERC (Feb. 3, 2002) ("the implementation of SMD will merely raise the price of electricity in the State"); Letter of Massachusetts Attorney General to ISO New England CEO (Feb. 4, 2003) (criticizing FERC's SMD concept as likely to raise wholesale costs). Both letters are available at www.iso-ne.com/iso_news/correspondence_with_public_officials.

has exploded.[19] In a growing number of areas, the transmission lines are carrying all the power they can.[20] Thus, the RTOs are expected to implement regional transmission expansion plans and require that member utilities invest billions in upgrades to the grid. One study showed that between $10 and $30 billion will be required just to bring transmission in the western United States back to a stable condition.[21] The necessary investment in transmission will not occur, however, if individual state regulators retain the right to second-guess RTO plans or the RTO's rates for the recovery of transmission upgrade costs by claiming inconsistency with the RTO system agreement.

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[19] *See Impact of the Creation of a Single MISO-PJM-SPP Power Market*, *supra* at 17-18; *National Transmission Grid Study* at 7, U.S. Department of Energy (May 2002); *Electricity Competition and the Need for Expanded Transmission Facilities to Benefit Consumers*, *supra* at 9-11; Robert W. Gee, *Expanding Our Electric Transmission Network: Consumers Have an Interest at Stake*, prepared for EEI (Sept. 2001), *available at* eei.org/issues/news/transmission_consumers_pdf; Robert W. Gale, *The Case For New Electricity Transmission and Siting New Transmission Lines*, prepared for EEI (Sept. 2001), *available at* www.eei.org/issues/news/transmission_case.pdf.

[20] For example, "in 1995, there were 25,000 transactions where electricity was sold from one region to another. [By 2000], the number hit 2 million." Fred Bayles, "California Readies for Blackouts," USA Today, Aug. 1, 2000.

[21] *See* Carl R. Danner, *The Western Transmission Grid: The Urgent Call for Investment* at 8, prepared for EEI (Sept. 2001), *available at* www.eei.org/issues/news/Transmission_Western.pdf. *See also* Hirst and Kirby, *Transmission Planning and the Need for New Capacity*, U.S. Department of Energy, National Transmission Grid Study: Issue Papers, at D-1 (May 2002) (estimating $56 billion needed for grid in the U.S. over next decade).

State regulators may also dispute the level of costs assigned to utilities in their states under the RTO's transmission service and wholesale sales tariffs. Under FERC's scheme, the RTO is operated under a "one stop shopping" approach – customers go to a single entity, the RTO, through which they can secure all the necessary rights to use the transmission grid in the region. The RTO collects the revenues from customers of these services at the FERC-regulated tariff rates. If retail regulators conclude that utilities in their states either overpaid for services acquired under the RTO tariffs or did not receive sufficient revenue from the RTO for the use of their facilities, they may not permit the utilities to be made whole for the costs they have incurred. As a result, the utilities will have trapped costs and will not recover for the services they supply at the retail level.

Plainly, the new FERC regime could not survive if utilities were subject to challenges in recovering some or all of these costs at the retail level. As recent events in California illustrate, when a utility's wholesale costs are "trapped" by state retail regulators, the utility suffers immediate financial repercussions. Its cash flow is disrupted, and its ability to finance capital improvements and make needed purchases of power is diminished. The adverse effects of such financial distress are felt by the utility's customers. Here, the entire new regional regulatory regime being created by FERC makes huge sums of money subject to decisions by regional entities operating under FERC's jurisdiction. Unless the states adhere strictly to the requirements of *MP&L* and *Nantahala* regarding trapping, this regime will fall apart.

B. *Pike County* Is Inapplicable Because There Is No Choice Involved

The LPSC claims that its actions are justified by an exception to the filed rate doctrine made by the Pennsylvania

state court in *Pike County Light & Power Co. v. Pennsylvania Pub. Util. Comm'n*, 465 A.2d 735, 737-38 (Pa. Commw. Ct. 1983). There, the Pennsylvania Commission had disallowed a portion of Pike County's purchased power expense, on the ground that Pike County could have purchased the power from an alternative supplier more cheaply. *Nantahala*, 476 U.S. at 972-73. Thus, the essence of the *Pike County* inquiry is whether the retail utility made a wise choice in entering into the transaction.

However, this element of choice does not exist for subsidiaries in holding companies or participants in RTOs because the individual utility lacks autonomy to make decisions regarding issues that affect the entity as a whole. FERC and the courts have consistently refused to apply *Pike County* in these circumstances. For example, FERC has refused to apply *Pike County* in the holding company context because the utility had no choice to buy power from other sources. *AEP Generating Co.*, 39 FERC (CCH) ¶ 61,158 at 61,630 (1987). Since the holding company decided the manner in which power would be allocated among its affiliates, those affiliates had no option to purchase power elsewhere. "Because the essence of the *Pike County* inquiry is whether a particular choice was wise, the lack of choice here makes such inquiry an empty one." *See id.* at 61,630. As a result, FERC held, the prudence of those purchases was within the exclusive jurisdiction of the FERC. The Fourth Circuit affirmed. *Appalachian Power Co. v. Public Serv. Comm'n*, 812 F.2d 898, 903 (4th Cir. 1987).[22]

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[22] Other courts have consistently held that *Pike County* is inapplicable when the utility has no choice. *See, e.g., Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 862 F.2d 69, 74 (3d Cir. 1988); *Gulf States Utils. Co. v. Public Util. Comm'n*, 841 S.W.2d 459, 469 (Tex.App.--Austin 1992, writ denied); *City of*

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This reasoning applies with even greater force in the RTO context. By FERC regulation, RTOs must be managed independently of the member utilities. Order No. 2000, at 31,063; 18 C.F.R. § 35.34(j)(1)(iii). Although the individual utilities serve customers in different states, they are without authority to modify or refuse to pay charges incurred pursuant to RTO tariffs or required as a result of RTO decisions or instructions. Under the FERC-filed tariff, once the RTO has made a decision, the member companies have no authority to change any of its terms. Thus, the *Pike County* exception would not apply to RTOs.

C. State Regulatory Complaints About The Administration Of Tariffs Filed By Multi-State Entities Should Be Brought Before The FERC

The LPSC recognizes that, in the end, FERC must resolve any disputes between state regulators about the meaning of multi-state system agreements. *See Cert.* Opp. at 21 ("[I]t is true that FERC is in the best position to make power and cost allocations that involve conflicting state interests."). Thus, the LPSC recognizes that FERC's interpretation, when provided, is authoritative. However it believes the states ought to be free to assert jurisdiction any time up until FERC acts. (Pet. App. 65a, 72a). Such a scheme would obviously frustrate implementation of the statute. The individual utility would be denied recovery of costs incurred under the filed rate at FERC and would be in the position of having to go back to FERC for a decision, and then obtain retroactive rate relief from the state agency after FERC acts.

Chicago v. Illinois Commerce Comm'n, 150 N.E.2d 776, 777, 780-81 (Il. 1958). *See generally Nantahala*, 476 U.S. at 972-73.

In the context of the Federal Power Act, this Court has never countenanced this kind of "wait for a conflict" procedure. It has always found Congress' grant of jurisdiction to be exclusive. In *Arkansas Louisiana Gas Co.*, 453 U.S. at 579, the Court held that a state could not assume a hypothetical rate different from that filed with FERC. In *Schneidewind v. ANR Pipeline Co.*, the Court held that the simple fact that there was an "imminent possibility" that the state action at issue would conflict with FERC jurisdiction supported a finding of preemption. 485 U.S. 293, 310 (1988). Likewise, in *MP&L*, the Court held that the Mississippi Supreme Court "erred in adopting the view that the pre-emptive effect of FERC jurisdiction turned on whether a particular matter was actually determined in the FERC proceedings." 487 U.S. at 374. "The only appropriate forum for such a challenge is before the Commission or a court reviewing the Commission's order." *Id.* at 375; *id.* at 379 (Scalia, J., concurring) (failing to seek FERC ruling "does not take the issue out of FERC's jurisdiction and recommit it to the States"). *See also Nantahala*, 476 U.S. at 970. As these cases recognize, it "is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject." *MP&L*, 487 U.S. at 377 (Scalia, J., concurring).

The only case cited by the LPSC for its view at the *certiorari* stage is distinguishable. *See Pan American Petroleum Corp. v. Superior Court of Del.*, 366 U.S. 656 (1961). That was a breach of contract action between two private parties. FERC had already declared what was the just and reasonable rate; thus, the state court was simply enforcing the rate set by FERC. That case does not support the proposition that a state can get out in front of FERC to decide the meaning of a FERC tariff and whether a violation has occurred.

The LPSC's position is not even feasible from a practical point of view. The LPSC would require the parties to engage in extensive litigation, all for naught. They would need to litigate before one or more state commissions until their efforts produced a conflict causing FERC intervention. Then the effects of the state litigation would need to be undone, perhaps retroactively. All this litigation would be a pointless waste of time, effort, and public resources.

It is no answer that concerned utilities can take questions about multi-state operating agreements to FERC. *See Cert.* Opp. at 21 ("Entergy could have asked the FERC for a declaration that compliance did not really require considering the matters set out in the tariff."). The utility would not know until the state commission's decision is issued that costs under the filed rate are being disallowed. To protect itself, the utility would have to file a declaratory action at FERC any time a state commission begins to investigate whether a violation has occurred. Moreover, it is unclear whether utilities would be able to recoup costs previously disallowed by the state commissions retroactively. Most utility rate regulatory regimes include rules prohibiting retroactive ratemaking.[23] Thus, a utility would have strong reasons to file a preemptive action with FERC to head off any state investigation.

Whereas placing the burden on the utility to seek anticipatory declaratory relief at FERC could swamp this already overburdened agency with much unnecessary litigation, the states are in a good position to judge when their

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[23] *See, e.g.*, La. R. S. § 45:1163.1; *Ford Motor Co. v. Michigan Pub. Serv. Comm'n*, 562 N.W.2d 224, 230 (Mich. App. 1997); *State v. Pub. Util. Comm'n*, 883 S.W.2d 190, 198-99 (Tex. 1994); *Wisconsin Power & Light Co. v. Pub. Serv. Comm'n*, 511 N.W.2d 291, 294 (Wisc. 1994).

complaints about the administration of a multi-state system agreement warrant a full federal proceeding. Congress contemplated that states would bring their complaints about federal tariffs to a neutral federal forum. For example, the states may file complaints about inter-utility activities (16 U.S.C. § 825e), and these complaints may ultimately result in FERC action declaring rates, practices and contracts unjust and unreasonable and establishing new ones (16 U.S.C. §§ 824e(a), 824d(e)). The states may also seek review of Commission orders in the federal courts (16 U.S.C. § 825*l*). FERC routinely handles complaints initiated by state utility commission, including ones filed by the LPSC.[24] Thus, states dissatisfied with conduct pursuant to a FERC-filed tariff of a multi-state entity may seek a determination from FERC that the tariff has been violated. What the states are precluded from doing, however, is making their own determinations that a multi-state entity has acted inconsistently with the terms of a federally filed tariff.

[24] *See, e.g., Louisiana Public Service Commission v. Entergy*, 102 FERC (CCH) ¶ 63,008 (2003); *Entergy Servs.*, 80 FERC ¶61,197 (1997). In the 1997 FERC proceedings that amended the tariff at issue here, FERC said that "'the regulations of the Commission provide a remedy for any'" violation of the amended tariff. *See Entergy Servs.*, 80 FERC at 61,789 & n. 50 (quoting Administrative Law Judge).

CONCLUSION

The judgment of the Louisiana Supreme Court should be reversed.

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March 3, 2003